Internal Revenue Service

memorandum

CC:TL-N-1268-89
TS/MAKEYES

date: 16 FEB 1989

to: District Counsel, [redacted]
Attn: [redacted]

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [redacted]

This memorandum is in reply to your request for clarification of technical advice issued by this office on October 2, 1988, regarding these same cases. In that technical advice we recommended that motions to dismiss be filed since petitioners had entered into complete closing agreements for the [redacted] year, thereby removing them from the TEFRA partnership proceeding. We also recommended changes to your proposed motions to dismiss. You are concerned with the advice we rendered regarding our interpretation of the closing agreement and the changes we recommended regarding the motions to dismiss. You also asked for clarification of our position regarding partial and complete settlements.

These cases involve [redacted] partnership. [redacted] is a cable television tax shelter created in [redacted]. Investors purchased interests in the partnership either by paying $[redacted] in cash or [redacted] in cash, and two promissory notes for $[redacted] and $[redacted], payable in [redacted] and [redacted]. Investors claimed losses based upon interest expense, depreciation, and other expenses (i.e. advertising, franchise fees, etc). The petitioners, the [redacted] and the [redacted], entered into closing agreements for [redacted], [redacted] and [redacted] based upon what appears to be a cash out of pocket settlement. The closing agreements also provided for allowable losses in future years to the extent of any remaining cash out of pocket.

On [redacted] a notice of FPAA was issued for [redacted] for the [redacted] year, and both petitioners filed notice partner petitions, alleging that they were entitled to $[redacted] of distributive losses based upon the terms of the closing agreement. However, petitioners are no longer parties to the

09047

action for [redacted] since they had executed settlement agreements which completely converted all their partnership items to nonpartnership items. 1/ Because there is no jurisdiction to file the petitions based upon the FPAA, petitioners cannot raise the issue as to whether they are entitled to deductions under the terms of the closing agreement. Likewise, our motions should not address the issue of whether petitioners are entitled to the deductions under the terms of the closing agreement since the Court has no jurisdiction to make such a determination. Clearly, matters regarding the closing agreements are not appropriately before the court. That being the case, we do not feel that your motion to dismiss needs to address the issue of whether petitioners are entitled to further deductions under the closing agreements. Rather, the focus of your motion should be that petitioners are no longer parties to the proceeding because of the closing agreement. Hence that is why we recommended that paragraph 15 be deleted from your motions. In that regard, paragraph 14 should also be modified to read that the Court lacks jurisdiction to make a determination of whether petitioners are entitled to losses for [redacted] under the terms of the closing agreement for the reasons stated in the motion, rather than stating respondent denies petitioners are entitled to such losses.

CLOSING AGREEMENT

You are concerned with our interpretation of the closing agreements; that being petitioners are entitled to their remaining cash out of pocket (subject, of course, to verification). Your position is that petitioners can not be allowed any remaining cash out of pocket for [redacted] since the notice of FPAA disallowed all partnership losses for that year. We disagree, and we stand by our original advice on the closing agreements.

The closing agreements allow petitioners their cash out of pocket investment as a deduction. This is a typical settlement offer in many tax shelters. Often the cash out of pocket is

---

1/ There were no other partnership items, other than partnership losses readjusted in the notice FPAA for [redacted]. Therefore, petitioners were removed from the partnership proceeding for [redacted] year. It is our position that, if the notice of FPAA for the [redacted] year has an item which is not covered in the closing agreements executed by petitioners, they would still be in the partnership proceeding for that year. However, it is also our position that, while petitioners would still be part of the partnership proceeding, they are bound to follow the closing agreement for the items to which it applies.

allowed for the initial year of the investment, however, the allowance of losses can also be spread over the years for which cash payments were made by the investors.

The closing agreements in these cases do not limit the deductions to the initial year, but rather specify the amounts which will be allowed for the [redacted], [redacted] and [redacted] years. Furthermore, the closing agreements provide that any further deductions in subsequent years are permitted to the extent of remaining cash out of pocket investment (i.e. initial cash investment minus the losses allowed for [redacted], [redacted] and [redacted]). The fact that the notice of FPAA does not allow any partnership losses for the [redacted] year does not mean no further deductions will be allowed to petitioners in subsequent years. The notice of FPAA is being issued and applies to those partners who have not settled the adjustments involved. The terms of cash out of pocket settlements are not contingent upon the partnership losses actually being allowed. In fact, in many cases where the cash out of pocket settlements are used, the underlying losses are totally disallowed. The purpose of cash out of pocket is to administratively move the settlement of tax shelter cases. You state that the National Office assumes petitioners have an "unfettered right to a cash-in deduction". The National Office does not assume taxpayers have an "unfettered right to a cash-in deduction", however, it is our position that we are legally obligated to honor our closing agreement, absent fraud, malfeasance or misrepresentation of material fact. We consider, based upon the terms of the closing agreements involved in these cases, that petitioners are entitled to their cash out of pocket, provided they can substantiate the amount of their cash out of pocket.

Again, we would reiterate that these motions to dismiss are not the proper motions to discuss whether petitioners are or are not entitled to further deductions. Petitioners are no longer part of the partnership proceeding for the [redacted] year, therefore, they can not petition the Court with a notice of FPAA. The petitions filed in these cases were based upon the notice of FPAA for the [redacted] year.

REVISIONS TO MOTIONS

As to the suggested changes for the motions to dismiss, we recommended that paragraphs 16 through 18 be deleted as they were repetitive of what you had alleged in paragraph 14, and as to the facts as presented in paragraph 10. If you are more comfortable repeating your allegations and explicitly stating that the closing agreement executed by petitioners was a settlement agreement within meaning of section 6231(b)(1)(c), we have no problem with that.

Paragraph 15 was deleted because it is not an issue the court has jurisdiction over in this case for reasons we have discussed. We agree that paragraph 14 should be modified to delete the sentence that states respondent denies petitioners are entitled to the losses, rather the paragraph should state the court lacks jurisdiction to make such a determination for the reasons you have already stated in your motion.

Paragraph 19 was deleted because your assertion implies that petitioners do not have a sufficient interest as requested by section 6226(d) because the amount of their allowable future losses would be insufficient as compared to the total amount of the overall partnership losses. If you were implying "sufficient interest" can be quantified numerically, that is not our position. If you were simply asserting that petitioners did not have a sufficient interest because they were no longer parties to the proceeding, you had already made that assertion.

As far as correcting the years in issue for each docket (as discussed in your footnote number 1), we agree with you.

PARTIAL / COMPLETE SETTLEMENTS

Finally, you ask whether the National Office attorney who would argue this contested motion would concede that, if ITC had been disallowed for [redacted] year, the closing agreements executed by petitioners would not be complete. Our position is that a partner's eligibility for the TEFRA partnership proceeding, once that partner has executed a closing agreement, will be determined by the extent of the closing agreement executed by that partner. If a partner signs a closing agreement covering all partnership items that are adjusted in a notice of FPAA for a particular year, that partner can not participate in the partnership proceeding; if the closing agreement does not cover all the items adjusted in the FPAA, that person can still participate in the partnership proceeding. However, that partner is also bound by the closing agreement terms as to the items specifically mentioned.

Our position on partial and complete settlements has been modified since the original technical advice was issued to you. Under the more conservative and preferable approach, any time a partnership item is settled, regardless of whether there are any remaining partnership items, that settled item converts and starts the one year period of assessment running under section 6229(f), for that settled item. If there are any other partnership items remaining, the partner is still part of the partnership proceeding for those items. Our previous position was the period of assessment for the partially settled item would not start running until there was a complete settlement.

Our current position is consistent with our previous advice regarding the fact that a partner may be out of TEFRA in one year and back in again for the following year. The change in our position does not affect the advice we had given you regarding the result of petitioners' closing agreements. The effect of the change in our position is to make the one year period of assessment for converted items applicable anytime a partnership item is settled, regardless of any remaining partnership items.

The basis of our position is the statutory framework of TEFRA. Although the area of what constitutes a settlement is not totally clear, we believe our position is correct based upon a reading of the statute and regulations. Naturally there are hazards associated with our position until the Court rules on that issue. In these cases, the taxpayers have executed closing agreements that remove them from the TEFRA proceeding, therefore, they can not petition the Court to enforce closing agreements based upon a notice of FPAA.

We have reviewed your most recently submitted motions to dismiss and we have one additional paragraph we recommend be inserted, then they should be filed. Should you have any further questions, please call Marsha Keyes of the Tax Shelter Branch, at FTS 566-4174.

MARLENE GROSS

By: Kathleen E. Whatley
KATHLEEN E. WHATLEY
Chief, Tax Shelter Branch